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IN THE

Supreme Court of the United States

OCTOBER TERM, 1951

No. 285

ALEXANDER GUTTMANN,
Petitioner,

v.

ILLINOIS CENTRAL RAILROAD COMPANY,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

The Petitioner, ALEXANDER GUTTMANN, prays that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit in the above case.

Opinions Below

The opinion of the United States District Court for the Eastern District of New York is reported in 91 F. Supp. 285 (App. 477).* The opinion of the Court of Appeals for the Second Circuit (R. 1) is reported in 189 F. (2d) 927.

*"App." refers to pages in the Appendix to the petitioner's brief in the court below, Part I of the record. "R." refers to additional portions of the printed record, Part III of the record.

Jurisdiction

The judgment of the United States Court of Appeals was entered on May 31, 1951 (R. 10). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1), 62 Stat. 928.

Questions Presented

The petitioner is a holder of non-cumulative preferred stock of the Illinois Central Railroad Company, an Illinois corporation. He brought this suit on behalf of himself and all other preferred stockholders of the Company. His petition seeks review of that part of the case in which the petitioner asserted that the directors had the power to declare and pay preferred dividends for certain prior years in which no dividends had been declared although they had been fully earned, and the earnings had not been consumed in capital improvements, or otherwise expended.

The court below construed the decision of this Court in *Wabash Railway Co.* v. *Barclay,* 280 U. S. 197, as holding that the directors had no such power, and as rejecting *Collins* v. *Portland Electric Power Co.,* 12 F. (2d) 671 (C. A. 9th, 1926), which held that the directors did have such power.

The petitioner will show that this construction of the *Wabash* decision is clearly erroneous, and that if this case had been brought in the State in which the court below was sitting (New York) the State courts would have placed a different interpretation upon the *Wabash* case and under their own precedents would have decided the case in favor of the petitioner.

The following questions are presented upon this petition:

(1) Whether this Court should review a decision of a Court of Appeals which conflicts with a decision of the Court of Appeals of another Circuit* and which erroneously interprets a decision of this Court, made prior to *Erie R. R.* v. *Tompkins,* 304 U. S. 64, when this Court's decision is the leading case in a field of business law of substantial economic importance, bearing particularly on a nationwide industry subject to federal regulation.

2. Whether in a diversity jurisdiction case such as this, a federal court correctly discharges its obligations under *Erie R. R.* v. *Tompkins, supra:*

(a) When in a corporate case, after finding no applicable law in the state of incorporation, it decides the issue presented as a matter of "general law" without considering what the courts of the State where the federal court is sitting would have decided once they had found no applicable law in the state of incorporation.

(b) When it disregards and fails to follow the applicable local decisions of the courts of the state in which it is sitting, construing and applying a decision of this Court made prior to *Erie R. R.* v. *Tompkins, supra,* and dealing with a question of business law.

Statute Involved

None.

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*As will be shown at p. 22, this conflict was not caused by differences in "local law decisions" such as obtained in *Ruhlin* v. *New York Life Ins. Co.,* 304 U. S. 202.

Statement of Facts

This case involves purely questions of law. The findings of fact by the District Court were accepted without challenge. The following summary is set forth for a convenient understanding of the legal issues involved.

Two classes of stock of the Illinois Central are outstanding, preferred and common. The preferred is non-cumulative. The preferred stock contract provides for 6% annual dividend payments out of "surplus or net profits", but neither the contract nor any Illinois statute or decision defines the term "non-cumulative". Eighty-eight per cent voting control has at all times been in the common stock.*

In the years 1942 to 1947 inclusive the railroad paid no dividends, despite the fact that in that period the annual preferred dividend requirements of $1,118,742 were earned 22 times in 1942, and 22, 16, 10, 7 and 13 times respectively in the following years through 1947. The railroad's net income, earned surplus, cash, and temporary cash investments in each of the years 1942 to 1949 inclusive were as follows:

Year	Net Income	Earned Surplus at Start of Year	Cash at End of Year	Temporary Cash Investment at End of Year
1942....	$24,914,000	$52,949,000	$11,140,000	$27,026,000
1943....	25,129,000	56,684,000	24,572,000	39,997,000
1944....	17,385,000	89,354,000	17,303,000	65,626,000
1945....	11,406,000	103,654,000	19,015,000	58,287,000
1946....	7,462,000	107,234,000	13,121,000	53,466,000
1947....	15,039,000	112,509,000	16,838,000	54,663,000
1948....	20,949,000	125,475,000	19,850,000	60,093,000
1949....	16,071,000	144,402,000	20,753,000	55,404,000

*The Court of Appeals, in footnote 2 of its opinion (at R. 3) stated that the Union Pacific Railroad holds about 25% of the common stock (*i.e.* 348,700 shares out of a total of 1,357,994) and was "therefore pretty obviously in control of the Board of Directors. Yet, that same railroad holds about 52% shares of the outstanding preferred (*i.e.* 98,270 out of a total of 186,457) . . ." In fact, however, after the Illinois Central's Chairman had testified that the Union Pacific

[Footnote continued on next page]

Since 1948 the railroad has paid dividends on the preferred, but has not made good any of the dividends passed in 1942-1947. In 1950, in the midst of this litigation, the directors resumed dividends on the *common* stock and in that year declared and paid to the common stockholders more than $4,000,000—nearly two-thirds of the total of the dividends which had been withheld from the preferred during the high earnings years of 1942-1947. The directors have continued to pay dividends on the common while declining to make good any of the passed earned preferred dividends.

In each of the years 1942-1947, when no preferred dividends were paid, the railroad's net income before depreciation far exceeded its expenditures for capital improvements; indeed, in the aggregate these capital expenditures were less than the cash thrown off by depreciation. In these years also, the railroad used some of its earnings to buy up its own outstanding bonds in the open market to ease the burden of its 1950-55 bond maturities. Despite all expenditures that had been made in 1942-1947 on both capital improvements and on bond purchases, huge accumulations of cash and temporary cash investments remained on hand as set forth in the above table and were available for dividends. The railroad claimed that these accumulations were retained in part because of certain contingent liabilities. By 1950, before the resumption of common dividends, these contingencies (as stated by the defendant) "had either substantially disappeared or had been satisfied by payments, for the most part far less than anticipated." In other words,

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did not exercise control over the Board of Directors a stipulation to that effect was entered in the record, as noted by the District Court in its findings (App. 113 and 474). The deductions of the court below thus are contrary to the testimony and stipulation.

a large part of the funds accumulated in the years 1942-1947 and available for preferred dividends have never been used by the defendant for any corporate purpose.

In the branch of the case of which review is here sought, the petitioner did not challenge the directors' discretion in withholding preferred dividends in each of the years 1942-1947. The petitioner contended, however, (a) that the railroad had and still has the *power* to pay the dividends so withheld, and (b) that on the facts in this case, when the directors in 1950 cut the melon of huge accumulated surplus earnings in favor of the common, they had a *duty* to exercise their power to pay the preferred stockholders the dividends so withheld.

Since the court below decided there was no power, this Court need consider only the propriety of the approach by the court below to that question, and need not reach the question of duty.

Reasons for Granting the Writ

I. The questions here presented are important both to the business community and to the proper functioning of the federal judicial system under the rule of *Erie R. R.* v. *Tompkins.*

More than forty railroads, including most of the leading Class I roads in the country, have non-cumulative preferred stock outstanding in aggregate par value amounts exceeding eight hundred million dollars. The following is a partial list of these roads with their outstanding non-cumulative preferred issues, taken from Moody's Steam Railroads, 1950.

Name of Railroad	State of Incorporation	Aggregate Par Value of Outstanding Shares of Non-cumulative Preferred Stock
*Union Pacific R.R.	Utah	$ 99,543,100
Atchison, Topeka & Santa Fe Ry.	Kansas	124,172,800
Atlantic Coast Line R.R.	Virginia	155,400
Baltimore & Ohio R.R.	Maryland	58,863,100
Brazil Ry.	Maine	4,736,200
Buffalo, Rochester & Pittsburgh Ry.	New York, Pa.	6,000,000
Carolina & North Western Ry.	N. C., S. C.	550,000
Central of Georgia Ry.	Georgia	15,524,000
Chicago, Milwaukee, St. Paul & Pacific R.R.	Wisconsin	112,174,000
Chicago, St. Paul, Minneapolis & Omaha Ry.	Wisconsin	11,259,300
Cincinnati, Indianapolis & Western R.R.	Indiana	5,350,000
Cleveland, Cincinnati, Chicago & St. Louis Ry.	Ind., Ohio	9,998,500
Colorado & Southern Ry.	Colorado	17,000,000
Copper Range R.R.	Michigan	1,138,000
Cuba R.R.	New Jersey	10,000,000
Detroit & Mackinac Ry.	Michigan	950,000
Erie R.R.	New York	40,340,400
Georgia Southern & Florida Ry.	Georgia	559,100
Guantanamo & Western R.R.	Maine	2,613,400
Kansas City Southern Ry.	Missouri	21,000,000
Kansas, Oklahoma & Gulf Ry.	Oklahoma	8,642,900
Louisville, Henderson & St. Louis Ry.	Kentucky	2,000,000
Midland Valley R.R.	Arkansas	3,999,250
Norfolk & Western Ry.	Virginia	21,990,200
Pennsylvania-Reading Seashore Lines	New Jersey	1,000,000
Reading Co.	Pennsylvania	69,961,750
St. Louis, Southwestern Ry.	Missouri	19,884,900

*The non-cumulative preferred stock of the Union Pacific is non-callable. The existence of its own non-cumulative, non-callable preferred may have been a persuasive factor in the Railroad's assuming a non-commital position with regard to the Illinois Central's preferred stock.

Seaboard Air Line R.R.	Virginia	15,000,000
Sierra R.R.	California	660,000
Sorocabana Ry.	Maine	2,000,000
Southern Ry.	Virginia	60,000,000
Terre Haute & Peoria R.R.	Illinois	1,837,400
Texas & Pacific Ry.	(Inc. by Act of Congress)	23,703,000
Vicksburg, Shreveport & Pacific Ry. Co.	Louisiana	2,142,800
Western Maryland Ry.	Md., Pa.	6,138,200
Western New York & Pennsylvania Ry.	Pennsylvania	6,951,250
Wisconsin Central Ry. Co.	Wisconsin	11,265,900

Clearly, it is in the public interest that the stockholders and directors of these railroads—and of other public utilities and leading industrial corporations with non-cumulative preferred stocks—should not be left in doubt as to the meaning and scope of this Court's decision in *Wabash Railway Co.* v. *Barclay, supra.* These and other persons need to be authoritatively informed by this Court as to what effect the *Wabash* case has had upon earlier and later federal and state court decisions which have held that the power does exist in corporate directors to pay passed but earned and unexpended non-cumulative preferred dividends. Otherwise, the decision of the court below which conflicts with all other holdings on the question will cause confusion.

The *Wabash* case is one of a number of leading decisions in which this Court, prior to *Erie R. R.* v. *Tompkins, supra,* by resort to "general law," made outstanding contributions to various important fields of business law. These cases will remain as landmarks although the federal courts' resort to "general law" has been stopped. The *Wabash* case in particular will be regarded, in the language of the court below, as a "lode-star", especially in all those numerous States where the meaning to be attached to the term "non-cumulative" has not yet been litigated. Clearly, it is in the

public interest that doubt as to the intention of this Court in the *Wabash* case should be removed.

Another question of paramount importance in determining the disposition of litigation in the federal courts is the approach which federal courts must use to interpret leading pre-*Erie* decisions of this Court on matters of general law. Should they, like the court below, interpret these decisions in accordance with their "own notions?" If they are free to interpret these pre-*Erie* federal cases in accordance with their own notions of what is right, the federal courts will be developing a new body of "general law" which will often conflict with the state law, thereby undermining the basic purposes of *Erie R. R.* v. *Tompkins, supra.* The only way of preventing the continuing development of "general law" is to require the federal courts to follow the interpretation of pre-*Erie* decisions of this Court by courts of the State in which they are sitting. Otherwise the federal courts will be recreating "general law" by the process of interpreting this Court's pre-*Erie* decisions, in which case this Court must continue to exercise its supervisory power over the lower federal courts.

The petitioner submits that this whole question of the proper role of the federal courts in dealing with leading pre-*Erie* decisions of this Court is one which is worthy of the attention of this Court.

The petitioner raises another important question concerning applicable law in the federal courts which will arise whenever the initial required reference to the law of a state other than the one in which the federal court is sitting reveals no decided cases to guide the federal court. This question appears to have been involved in this Court's granting the writ of certiorari in *D'Oench, Duhme & Co., Inc.* v. *Federal Deposit Ins. Co.,* 315 U. S. 447, 455. This ques-

tion, like the one above, grows out of the rule in *Erie R. R.* v. *Tompkins, supra.*

II. The interpretation of this Court's opinion in *Wabash Railway Co.* v. *Barclay* by the court below is clearly erroneous. It is in conflict with the interpretation placed upon that case by the applicable local law decisions (New York). It lays down a rule which is in conflict with the rule in the Ninth Circuit and with prevailing authorities on the point.

The court below summed up the holding in the *Wabash* case as follows:

> "In the *Wabash* case, plaintiffs, holders of non-cumulative preferred stock, sought an injunction preventing the defendant railroad company from paying dividends on the common stock unless it first paid dividends on the non-cumulative preferred to the extent that the company, in previous years, had had net earnings available for that payment and that such dividends remained unpaid. The Court decided against the plaintiffs. It spoke of the fact that, in earlier years, 'net earnings that could have been used for the payment were expended upon improvements and additions to the property and equipment of the road'; it held that the contract with the preferred meant that 'if those profits are justifiably applied by the directors to capital improvements and no dividend is declared within the year, the claim for that year is gone and cannot be asserted at a later date.' "

The court below then said:

> "We take that as a ruling that the directors were left with no discretion ever to pay any such dividend."

The court below dismissed the petitioner's contention that this Court in the *Wabash* case had deliberately limited the application of its decision to a case where, in Justice Holmes's language quoted above, "profits are justifiably applied by the directors to capital improvements and no dividend is declared within the year . . ." The court below said:

> "There is no sensible ground for singling out legitimate capital outlays, once made, as the sole cause of the irrevocable destruction of the claim of the preferred. We do not believe that the Supreme Court gave the contract with the preferred such an irrational interpretation. It simply happened that in the *Wabash* case the earnings had been used for capital additions, and that, accordingly, the court happened to mention that particular purpose. *Consequently, we think that the Court, in referring to that fact, did not intend it to have any significance.*" (Italics ours)

The petitioner submits that in thus dismissing Justice Holmes's carefully limited phraseology as lacking "any significance," the court below made a fundamental error. It can be demonstrated, we believe, that Justice Holmes's opinion was deliberately intended not to disturb prior decisions—particularly that of the Court of Appeals for the Ninth Circuit in *Collins* v. *Portland Electric Power Co., supra*—which expressly recognized the *power* of directors to make good earned but unpaid non-cumulative preferred dividends out of earned surplus carried over from prior years.

The state of the prior authorities, the pleadings in the *Wabash* case (upon which alone the case was tried), the

nature of the opinions in the courts below, and the arguments advanced to this Court by counsel for the Wabash Railway Company (the late Charles Evans Hughes) make manifest the deliberately limited character of Justice Holmes's opinion.

The Prior Authorities

It has always, of course, been the rule that in years in which non-cumulative preferred dividends have not been *earned* they are "lost forever" and no power remains in the directors to declare and pay them at some subsequent time. This risk incurred by non-cumulative preferred stockholders is the basic characteristic of that type of stock and is a serious enough risk to explain the relative disfavor in which non-cumulative preferred stock has come to be held.

On the other hand, where non-cumulative preferred dividends are fully earned, as in the instant case, and the directors determine for one reason or another not to declare them, the rights of the preferred stockholders are not so summarily disposed of. Until the decision in the instant case, no court had gone so far as to hold, in the absence of explicit and compelling language in the charter, that if the dividends have been fully earned in a given year but not paid, all *power* to make them good in subsequent years is forever taken from the directors, regardless of the use, if any, to which the withheld earnings were put.

Very early the question arose: if directors withhold the earnings to take care of possible contingencies—as they did in the instant case—and later find that they do not need the funds so withheld—as they found in the instant case—have they the *power* to distribute the unneeded surplus to

the preferred stockholders in the way of dividends for the years in which though earned they were passed? Without reference to any statute and on broad equitable grounds *Bassett* v. *U. S. Cast Iron Pipe and Foundry Co.*, 74 N. J. Eq. 668, 70 Atl. 929 (1908), *aff'd* 75 N. J. Eq. 539, 73 Atl. 514 (1909), answered the question in the affirmative.* The power was also expressly affirmed in *Collins* v. *Portland Electric Power Co., supra,* which while it involved an Oregon corporation was decided as a matter of "general law." The rule in the *Collins* case was expressly approved in *Morse* v. *Boston & Maine R. R. Co.,* 263 Mass. 308, 160 N. E. 894 (1928). See also *Star Publishing Co.* v. *Ball,* 192 Ind. 158, 134 N. E. 285 (1922). As will be seen, *infra,* pp. 19-21, the power was again affirmed by the New York courts after the rendition of the *Wabash* decision. Until the decision below the power of the directors to make good the passed dividends had been consistently affirmed and no holding had challenged it.

In *New York, Lake Erie & Western R. R.* v. *Nickals,* 119 U. S. 296,** an affirmative answer was given to another question involving non-cumulative preferred—where earnings have been justifiably expended on capital improvements, should all dividends for the years in question be cut off? The answer given was compelled by the policy adhered to by the courts that operational necessities should in the public interest take precedence over the claims of all

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*It is worth noting that the decision in the *Bassett* case, a leading case and well known to the bar, was handed down prior to the issuance of the preferred stock of the Illinois Central Railroad (which was in 1922).

**The *Nickals* case was the only case cited by Justice Holmes in his opinion in the *Wabash* case.

security holders, including bondholders.* It follows that if income were permanently dedicated to capital improvements and no provision made for recoupment through depreciation, those earnings would necessarily be lost for other corporate purposes. Until 1943 railroads were not required to depreciate their roads (as distinguished from equipment) and therefore frequently made capital expenditures out of current income. *Union Pacific R. R.* v. *United States,* 99 U. S. 402. Therefore, net earnings used for capital improvements were necessarily not available for other purposes.

The Wabash Case

The state of the law at the time of the *Wabash* case was as described above.

The *Wabash* case was determined on motion upon a set of pleadings which presented the strongest possible case for applying the long-established doctrine of the *Nickals* case. For the pleadings stated that the case for decision was one where all of the earnings of the company, with the sole exception of those for the current year, had been consumed in capital expenditures and locked up in working capital essential for day-to-day operation, so that—as admitted by the plaintiff preferred stockholder—"no part of such alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends."**

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*Thus, application of net earnings to capital improvements relieves the directors of an obligation to pay interest on income bonds, even though there was net income for the year. *Missouri Pac. R. Co.* v. *Texas & Pac. Rwy. Co.,* 282 Fed. 61 (C. A. 5th, 1922). So in *Burk* v. *Ottawa Gas & Electric Co.,* 87 Kan. 6, 123 Pac. 857 (1912), preferred stock dividend requirements construed to be mandatory were subordinated to the making of necessary capital extensions.

**The factual situation thus depicted by the *Wabash* pleadings was diametrically opposite from that in the case at bar where, as already noted, huge accumulations of cash and temporary cash investments remained on hand throughout all the period at issue after all expenditures for capital improvements and for purchases of funded debt had been made.

The plaintiff nevertheless insisted that even though the only funds available were current earnings, non-cumulative preferred dividends must be paid for the past years in which they had been earned before any payments could be made to the common. In other words, according to the preferred, current earnings should be used to pay the passed preferred dividends. A majority of the Court of Appeals upheld this contention.

The late Charles Evans Hughes, who filed the petition for certiorari and brief in support thereof for the Wabash Railway Co., and later, after certiorari had been granted, filed the brief for the Railway in the successful proceeding before this Court, which reversed the Court of Appeals, emphasized very strongly the distinction between the facts in the *Wabash-Nickals* type of case and the facts in the *Collins* type of case. In his brief in support of the petition he pointed out that under the pleadings in the *Wabash* case it had been shown that the "entire surplus earnings of all periods since its incorporation not actually distributed to the stockholders and reserved for working capital or necessary corporate requirements has been actually appropriated to and is now represented by *fixed and permanent improvements and additions to the property and equipment of the Railway Company to enable it adequately to discharge its public duties and protect its property and that no part of its alleged surplus is represented by any cash or liquid fund or by any accumulation of cash assets available for dividends.*" (Emphasis by Mr. Hughes)*

He also stated that *Collins* v. *Portland Electric Power Co., supra,* "did not touch the fundamental question decided in the present case by the Circuit Court of Appeals."**

*Brief in Support of Petition for Writ of Certiorari, p. 14.
**Id., at p. 20.

In his brief for the petitioners after certiorari had been granted Mr. Hughes made the distinction in even more forceful terms. He first stated what the directors of the Wabash Railway Co. had done as follows:

> "The Board of Directors of Wabash Railway Company in the early period following reorganization, not only did not declare preferred dividends but determined to invest earnings in plant and equipment, a determination which forecloses any claim by the preferred stockholders against such earnings unless the action of the Directors involved an abuse of discretion, which it is conceded is not the case."*

He then immediately adverted to the *Collins* type of situation to show that the Court did not have before it any issue of the directors' power to pay passed dividends where the earnings had not been devoted to capital purposes:

> "What the right, if any, of the preferred stockholders would be if the Board of Directors should subsequently change its policy and determine to distribute earnings theretofore withheld from the preferred stock is a question *which does not arise in the present case.* This is *not* a case where earnings previously invested in the property of the Railway Company or held for working capital are released from such appropriation and are to be distributed in whole or in part. This is a case where these investments are still held intact and not distributed and where the preferred stockholder is seeking to establish an equitable lien or credit against invested surplus and thereafter to require the invested surplus to be liquidated for his account by the use of subse-

*This passage and the subsequent quotations are from pp. 14-15 of the Brief.

quent earnings, in short it is a case where the preferred stockholder is seeking to do what this Court in the *Nickals* case said he could not do, namely, *fasten* an undeclared non-cumulative dividend on the profits of succeeding years" (Italics ours).

Mr. Hughes's brief then turned to a passage in Judge Hand's dissenting opinion* in which he distinguished the *Bassett* and *Collins* type of case from that at bar; once again the brief emphasized the fact that the rule in these cases was *not* involved in the *Wabash* case:

> "In his dissenting opinion in the Circuit Court of Appeals, Circuit Judge Learned Hand seems to assume that if the Directors hereafter should wish to reduce the working capital accumulated out of past earnings, they would probably be obliged to declare as preferred dividends the amount so withdrawn. Whatever plausible reasons may be assigned for this assumption, in support of which Judge Hand refers to two cases [i.e., *Bassett* and *Collins*] considered at a subsequent point in this brief, the question of what the rights of non-cumulative preferred stockholders would be in a dividend distribution of such a fund does *not arise in this case, and is not now before this Court*" (Italics ours).

Finally, in an extensive discussion of the *Collins* case, Mr. Hughes argued that the Ninth Circuit Court had not taken the position urged by the plaintiff in the *Wabash* case but had merely held that "the discretionary power of the Board in the matter of dividends is not lost if not immediately exercised. . . ."

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*30 F. (2d) 260, 267.

In the light of the opinions below in the *Wabash* case, the pleadings and of the strong representations made in Mr. Hughes's brief that the rule in the *Collins* case was in no way involved, Justice Holmes's short but careful opinion becomes crystal clear. In denying the plaintiff relief he cited but one case—the *Nickals* case. He pointed out explicitly that he was dealing with a case in which all net earnings that could have been used for non-cumulative dividends "were expended upon improvements and additions to the property and equipment of the road," and held, very simply and concisely, that if profits "are justifiably applied by the directors to capital improvements and no dividend is declared within the year, the claim for that year is gone and cannot be asserted at a later date." That, and no more.

The foregoing analysis compels the conclusion that the court below erred when it said that this Court in the *Wabash* case, in referring to the fact that the earnings had been used for capital additions, "did not intend it to have any significance." And the court below similarly erred when it summarily dismissed the Ninth Circuit's holding in the *Collins* case as "at odds with the rationale of the *Wabash* decision." Surely, having before him the distinction drawn by Mr. Hughes in his argument for the Railway company to the effect that the rule in the *Collins* case was in no way involved in the *Wabash* case, if Justice Holmes had intended in his opinion to overturn that rule, he would have said so. Instead, he did not mention the *Collins* case, and he carefully limited his description of the facts and the ground for the Court's decision in such a way as to patently exclude cases of the *Collins* sort.

Authorities Since the Wabash Case

In New York the effect of *Wabash* on *Collins* has been twice considered. And the result reached by the courts is diametrically opposite to that reached by the court below. *Gallagher* v. *New York Dock Co.*, 19 N. Y. S. (2d) 789 (Sup. Ct., 1940), *aff'd* 263 App. Div. 828, 32 N. Y. S. (2d) 348, *appeal denied*, 263 App. Div. 957, 32 N. Y. S. (2d) 1021, and 288 N. Y. 737; *Diamond* v. *Davis*, 38 N. Y. S. (2d) 103 (Sup. Ct., 1942), *aff'd* 39 N. Y. S. (2d) 412, 265 App. Div. 919, *aff'd* 292 N. Y. 554.

In the *Diamond* case the New York Supreme Court, in a case holding that directors had the power to pay passed dividends, said:

> "Plaintiff relies upon and contends that the case of Wabash Railway Co. v. Barclay (280 U. S. 197), supports the argument that non-cumulative stock is only entitled to a dividend if declared during the year out of the annual profits for that very year and that if such profits have been applied to capital improvements and no dividends are declared within the year for that year no profits out of which dividends may be declared exist, and *the power to declare same is gone, and dividends cannot be granted* or claimed at a later date.
>
> "Examination of that case shows that it applied to its facts which are different than those in the matter at bar. The corporation involved there was organized under the laws of Indiana, and the *'expenditures' in that case were for permanent capital improvements.*
>
> "The earnings there, unlike the case at bar, were retained in the business in such manner as to preclude withdrawal therefrom for the payment of dividends. Here the retention of the surplus net earn-

> ings by Rubber Company, if one did exist, was not an irrevocable and permanent withholding" (pp. 121, 122; italics ours).

This construction was not casually arrived at, for issue was joined upon it, as shown by the brief filed by the attorneys for the defendant company in the New York Court of Appeals (the same attorneys who are now representing the defendant Illinois Central in the instant case), in which they stated at p. 26:

> "The gravamen of the decision in the Wabash case was '* * * *if profits are justifiably applied by the directors to capital improvements* and no dividend is declared within the year, the claim for that year is gone and cannot be asserted at a later date.' (280 U. S. 197, 203; italics ours). Even the Wabash decision, therefore, furnishes no authority for appellants' position in the case at bar [that the directors had no power to pay the back non-cumulative dividends] because the 1938 earnings of the rubber company are not alleged to have been applied by the directors to capital improvements, but such earnings were merely left in the surplus of the company, as the appellants themselves say in their brief (pp. 84, 103)." (The italics are the attorneys' own.)
>
> "Transferring the annual earnings to the surplus account does not render the earnings unavailable for dividends."

The court below disposed of the *Davis* case in a footnote, merely observing that it involved a New Jersey corporation. However, the New York Court's construction of the *Wabash* case as being limited to capital improvements stood upon its own footing and in no way turned upon the place of incorporation.

In the *Gallagher* case, *supra,* the New York court was dealing with a New York corporation. In one phase of

that case the common stockholder plaintiff challenged the payment in one year by the directors of a discretionary non-cumulative preferred dividend for an earlier year which had been fully earned but not paid. The court directly upheld the directors' power to do this. 19 N. Y. S. (2d), at p. 794. The court in a later part of the opinion dealing with another phase of the case quoted from the *Wabash* case about the extinguishment of dividend rights by capital expenditures. It then set forth at length and with approval those passages from the Ninth Circuit Court's opinion in the *Collins* case upon which the petitioner here has relied.

The Supreme Court of Massachusetts likewise interpreted *Wabash* as the New York cases did and in the manner contended for by the petitioner. *Joslin* v. *Boston & Maine R. R.*, 274 Mass. 551, 175 N. E. 156 (1931).

Leading text-writers and commentators have asserted, contrary to the court below, and in accord with the New York courts, that the *Wabash* case did not impair the validity of the rule in the *Collins* case. See, for example, the Note in 67 A.L.R. 765, 774 (1930); 12 FLETCHER, CORPORATIONS, § 5447 (1932); 4 WHITE, NEW YORK CORPORATIONS (12th ed. 1950) § 116.4; STEVENS, CORPORATIONS (2d Ed. 1949) 477-479; Notes, 3 So. CALIF. L. REV. 215 (1930); 43 HARV. L. REV. 829 (1930); 18 CALIF. L. REV. 318 (1930); 8 N.Y.U. L. Q. 138 (1930). Other authorities, while not expressly considering the effect upon the *Collins* case, have treated the *Wabash* case as limited to a situation where earnings have been expended on capital improvements. See 30 COL. L. REV. 260 (1930), 39 YALE L.J. 581 (1930), 14 MINN. L. REV. 417 (1930), 64 U.S.L.R. 211 (1930), 28 MICH. L. REV. 763 (1930), 8 No. C. L. REV. 296 (1930), 16 VA. L. REV. 717 (1930), 10 BOSTON UNIV. L. REV. 404 (1930); 25 ILL. L. REV. 148 (1930).

In no authorities that we have been able to find has it been suggested that the *Wabash* decision is in conflict with the rule in the *Collins* case.

It is submitted that in view of the importance of the *Wabash* case to the future development of corporate law, and to avoid confusion as to what this Court meant by its holding, the decision in the court below should be reviewed. This is especially so because the decision of the court below conflicts with the decision of the Court of Appeals for the Ninth Circuit. If the conflict resulted from a corporate rule of law varying in two separate states, a different situation would be presented. *Ruhlin* v. *New York Life Ins. Co.*, 304 U. S. 202. But the conflict here is not based upon, or due to, differences in the Oregon law and the Illinois or New York law, but grows out of an erroneous interpretation of an opinion of this Court by another federal court. Furthermore, the decision below is in conflict with the applicable local decisions. Since this Court's opinion is a leading case on the question of non-cumulative preferred dividends, the law will become unsettled until the matter is determined. Only this Court can authoritatively settle what it meant in one of its earlier opinions.

III. The court below in derogation of *Erie R. R.* v. *Tompkins*, *supra*, and *Guaranty Trust Company of New York* v. *York*, 326 U. S. 99, decided the case contrary to the way the courts of the State in which it was sitting would have decided it.

Two questions of importance, touching upon the interrelationship of the federal and state courts, and determining the disposition of litigation in the federal courts, are here presented: (a) application of the proper law—state or "general"; (b) the interpretation of pre-*Erie* decisions of

this Court on matters of what were formerly "general law". This Court has held that "for purposes of diversity jurisdition a federal court is 'in effect, only another court of the State' . . ." *Woods* v. *Interstate Realty Co.,* 337 U. S. 535, 538. It is submitted that this holding should be applied to both questions, which are here considered in order.

(a)

In all diversity cases a federal court must apply the local law, including the state's conflict-of-laws rule. *Klaxon* v. *Stentor Electric Mfg. Co.,* 313 U. S. 487. And in applying the state's conflict-of-laws rule the federal court must apply the local internal law where the state would have done so, although the federal court is of the opinion that a "better result" might be reached if another law was applied. *Griffin* v. *McCoach,* 313 U. S. 498.

The court below, however, acted in a manner contrary to these and other decisions of this Court. Once it had determined that there was no Illinois statute or decision to guide it, the court below applied its own notions of what the contract meant, instead of attempting to find out what a New York court does when it determines that there is no guiding Illinois law. The approach of the court below is embodied in the following paragraph of its opinion:

> "Our lode-star is *Wabash Railroad Co.* v. *Barclay,* 280 U. S. 197, which dealt with the non-cumulative preferred stock of an Indiana railroad corporation. But there were no controlling Indiana decisions or statutes on that subject. The United States Supreme Court was therefore obliged to interpret the contract according to its own notions of what the contract meant. *We have a similar problem here,*

> since there are no Illinois decisions or statutory provisions which control or guide us." (Italics added.) 189 F. (2d) 927, 928.

But the problem was not "similar". *Erie R. R.* v. *Tompkins* had intervened. And the choice-of-law rule in *Wabash* became " 'obsolete' insofar as it was 'based on a view of diversity jurisdiction which came to an end with *Erie R. R. Co.* v. *Tompkins* . . .' " *Woods* v. *Interstate Realty Co., supra,* at 537. The court below thus approached the problem before it in an improper manner. And having done so, its conclusion as to what law it was to follow necessarily was erroneous. It said:

> "Absent such decisions and statutes, [in Illinois] we must take the *Wabash* opinion as expressing the correct interpretation of the rights of non-cumulative preferred stockholders of this Illinois corporation." 189 F. (2d) 927, 928.

After determining that there were no Illinois decisions or statutes to guide it, the court below should have referred back to the New York choice-of-law rule and should have considered what a New York court would have done when faced with the problem of the absence of guiding law in the state of incorporation. *Klaxon* v. *Stentor Electric Mfg. Co., supra; D'Oench, Duhme & Co., Inc.* v. *Federal Deposit Ins. Co., supra,* 455. Such reference to New York law would have obliged the court below to apply the internal law of New York. For the New York courts have held in a contract case involving rights of corporate bondholders:

> "The plaintiffs have failed either to plead or prove the law of Pennsylvania, as it bears upon the language of the principal obligation or the guaranty. Accordingly we may proceed upon the assumption that the law of the foreign jurisdiction accords with

the law of New York upon the subject." *Read* v. *Lehigh Valley R. R. Co.,* 284 N. Y. 435, 441, 31 N. E. 2d 891.

In another New York case it was held:

". . . Where no [foreign] law is available by proof or with aid or presumption, the court in the absence of presumption or proof, is relegated to the applicable law of the forum * * *." *Smith* v. *Compania Litografica De La Habana,* 217 N. Y. Supp. 39, 43, 127 Misc. 508, 222 N. Y. Supp. 902, 220 App. Div. 782.

This rule is well settled. *International Text Book Co.* v. *Connelly,* 206 N. Y. 188, 200, 201, 99 N.E. 722; *Matter of Marchant* v. *Mead-Morrison Mfg. Co.,* 252 N. Y. 284, 303, 169 N.E. 386; *Weissman* v. *Banque De Bruxelles,* 254 N. Y. 488, 495, 173 N.E. 835; *Cherwien* v. *Geiter,* 272 N. Y. 165, 168, 5 N.E. 2d 185; *Zwirn* v. *Galento,* 288 N. Y. 428, 432, 43 N.E. 2d 474; *Schweitzer* v. *Hamburg-Amerikanesche Packetfahrt Actien Gesellschaft,* 134 N. Y. Supp. 812, 814, 194 App. Div. 900; see NEW YORK ANNOTATIONS OF THE RESTATEMENT OF CONFLICT OF LAWS. §§ 622, 623, pages 403-406. This rule has been reaffirmed as applicable under section 344a of the New York Civil Practice Act. *Arams* v. *Arams,* 45 N. Y. S. (2d) 251, 254, 255; *Unterberger* v. *Boxer,* 69 N. Y. S. 2d 372, 373, *Matter of McDougald,* 272 App. Div. 176, 202; *Matter of Borden,* 41 N. Y. S. 2d 269, 274, *affirmed,* 267 App. Div. 823, 47 N. Y. S. 2d 120, *appeal denied,* 267 App. Div. 905, 47 N. Y. S. 2d 583; *cf. Cherwien* v. *Geiter,* 272 N. Y. 165, 168, 5 N.E. 2d 185.

Therefore, the court below clearly erred in applying "general law." Accordingly, this Court should itself,* or

Rorick v. *Devon Syndicate,* 307 U. S. 299.

direct the court below to* inquire into what the New York courts would have done. As already stated, the New York courts in interpreting similar non-cumulative preferred stock contracts, have held that directors have power to pay earned and unexpended dividends on non-cumulative preferred stock even though the year in which the net profits were earned has passed. *Gallagher* v. *New York Dock Company, supra,* and *Diamond* v. *Davis, supra;* see 4 WHITE, NEW YORK CORPORATIONS (12th ed. 1950) §116.4.

(b)

The other question, important in the disposition of litigation in the federal courts, is whether pre-*Erie* decisions of this Court are to be interpreted by the federal courts without regard to, and indeed contrary to, interpretations of those same decisions by the courts of the state in which the federal court is sitting. This question has never previously been decided by this Court.

It is clear that the court below interpreted the *Wabash* case and determined its effect on the rule in the *Collins* case, without considering what the New York courts have held to be the meaning and scope of the *Wabash* case. It is submitted that this disregard of the New York interpretations of the *Wabash* case does violence to the *Erie* rule, for "*Erie R. R. Co.* v. *Tompkins* has been applied with an eye alert to essentials in avoiding disregard of state law in diversity cases in the federal courts." *Guaranty Trust Company of New York* v. *York, supra,* at p. 110.

As already shown at pp. 19-21 above, the New York courts, in *Diamond* v. *Davis* and in *Gallagher* v. *New York Dock Company* have treated the *Wabash* case as limited to the extinguishment of dividend rights when earnings are

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Griffin v. *McCoach,* 313 U. S. 498.

applied to capital improvements, and as not in conflict with the Ninth Circuit rule announced in the *Collins* case, *supra*.

It is submitted that federal courts in diversity cases should be required to follow the interpretations of pre-*Erie* federal decisions by the courts of the states in which they are sitting, since the federal courts are no longer free to apply "general law" when determining a business law question. Interpretation of cases from other jurisdictions, including a pre-*Erie* decision of this Court, is as much a part of the law of the state in which the court is sitting as other determinations of what the particular state law is. *Cf. West* v. *American Telephone & Telegraph Co.*, 311 U. S. 223, where this Court held that a federal court is obligated to follow state law as it is at the time of the federal court's decision, using all available sources and data.

If federal courts are permitted to interpret pre-*Erie* decisions of this Court on matters of general law without being obliged to follow the state's interpretation of those decisions, there will inevitably develop a new body of "general law". This is precisely what *Erie R. R.* v. *Tompkins* was supposed to prevent. The existence of such an independent body of law will be particularly troublesome if this Court determines that it will never review a lower federal court's interpretation of its pre-*Erie* decisions on matters of "general law", since the various federal courts will not always interpret these pre-*Erie* decisions in a uniform manner. And the differences in interpretations will not be based upon permissible differences in "local law decisions," but will be caused by the federal courts' assumption of a power to interpret pre-*Erie* federal decisions according to their own notions without being bound by local decisions. Thus the result in a particular case would, as in the pre-*Erie* era, and, as in this case, depend upon whether a federal or a state forum was selected.

Conclusion

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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Dated: August 27, 1951.

OCT 3 1951
CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

October Term, 1951

No. 285

ALEXANDER GUTTMANN,
Petitioner,

against

ILLINOIS CENTRAL RAILROAD COMPANY,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF ILLINOIS CENTRAL RAILROAD COMPANY IN OPPOSITION

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October 2, 1951.

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§ 1254(1), United States Code, Judiciary and Judicial Procedure 2

IN THE

Supreme Court of the United States

October Term, 1951

ALEXANDER GUTTMANN,
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against

ILLINOIS CENTRAL RAILROAD COMPANY,
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No. 285

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF ILLINOIS CENTRAL RAILROAD COMPANY IN OPPOSITION

OPINIONS BELOW

The opinion of the District Court of the United States for the Eastern District of New York appears in 91 F. Supp. 285. The opinion of the Court of Appeals for the Second Circuit is reported in 189 F. 2d 927.

JURISDICTION

The judgment of the Court of Appeals was entered on May 31, 1951 (R. 9).[1] The petition for a writ of certiorari

[1] "App." refers to pages in the Appendix to petitioner's brief in the court below, now marked Part I of the record as filed in this Court; "Def. App." to pages in the Appendix to respondent's brief below, presently marked Part II of the record; and "R." to the additional portions of the printed record, marked Part III of the record.

was filed on August 28, 1951. This Court's jurisdiction is invoked by petitioner under § 1254(1) of the United States Code, Judiciary and Judicial Procedure.

QUESTIONS PRESENTED

Petitioner in support of his application for certiorari would make it appear to this Court

(1) that there is a conflict in the decision of the Court of Appeals for the Second Circuit in the instant case, resulting from its alleged misinterpretation of this Court's opinion in *Wabash Railway Co.* v. *Barclay,* 280 U. S. 197 (1930), and a 1926 decision of the Ninth Circuit Court of Appeals in *Collins* v. *Portland Electric Power Co.,* 12 F. 2d 671; and

(2) that the court below did not properly discharge its obligations under the mandate of *Erie R. R.* v. *Tompkins,* 304 U. S. 64, by allegedly failing to apply the law of the State of New York, which petitioner *for the first time* asserts is controlling in this case.

As we shall presently demonstrate, the alleged conflict of decisions between the Second and the Ninth Circuits is a mere fantasy, and there has been no violation of the *Erie R. R.* v. *Tompkins* doctrine.

STATEMENT

(a) Decision of the District Court

This suit was brought in July 1948 to recover undeclared dividends on the non-cumulative convertible preferred stock of the respondent railroad company for each of the 11 years,

1937 to 1947, inclusive. The petitioner, the owner of 200 shares of that stock acquired in 1944 and 1945 (App. 457), purported to act on behalf of all the preferred stockholders, although no other stockholder brought suit or attempted to intervene despite the fact that dividends were not paid on any stock of respondent from 1931 to 1948 (App. 455, 459).

In the District Court petitioner asserted, in substance, that as the net earnings and surplus of the company exceeded the amounts required for the payment of preferred dividends in each of the years 1937 to 1947 inclusive, there was an absolute, fixed obligation under the terms of the contract between the company and its preferred stockholders[2] to declare and pay preferred dividends in each of these years (as in the case of income bonds); and that, even if no such absolute obligation existed, the exercise of sound discretion by the board of directors required their payment in any event (App. 426). The respondent maintained that the non-declaration of such dividends was justified in the exercise of sound business judgment and discretion by the directors of the company (App. 426).

The experienced trial court in interpreting the contract between the company and its non-cumulative preferred stockholders held, after citing applicable decisions of the

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[2]The resolution of the Illinois Central stockholders authorizing the preferred stock (App. 28-9) reads in part as follows:

> "The preferred stock shall be entitled to receive out of the surplus or net profits of the Company in each fiscal year dividends * * * before any dividends shall be paid upon the common stock, but such dividends shall be non-cumulative.
>
> The dividend dates for all series of such preferred stock shall be identical and no dividends shall be paid, declared or set apart for payment on the common stock of the Company in any fiscal year unless the full dividend on the preferred stock for such year shall have been paid or provided for."

Similar wording is contained in the preferred stock certificates (App. 458-9).

courts of Illinois, where the company was incorporated, as well as decisions of this Court and of New York, that the directors were clothed with discretion regarding dividends, and that the mere presence of earnings in any particular year gave rise to no absolute right in the preferred stockholders to dividends as claimed by the petitioner (App. 441-50). The District Court also determined on the evidence presented at the trial that the discretion of the directors in not declaring the dividends was justifiably exercised, and that no rights to such dividends survived such exercise of discretion (App. 453-5, 474-5). The complaint and supplemental complaint were accordingly dismissed, and judgment was entered in favor of the company (App. 477).

(b) Decision of the Court of Appeals

In the Court of Appeals petitioner abandoned his claim that there was an absolute right to dividends for any year in which the company had earnings, taking the position that whenever in any year earnings were "justifiably expended in capital improvements", the preferred stockholder's right to dividends for that year was lost forever. But he claimed further that where earnings were not so expended, the right to dividends for that year always survived and must be recognized and satisfied at some time by the corporation, and that under such circumstances the directors had no discretion in the matter. As a result of this change in position, the petitioner completely withdrew any claim for the five years, 1937-1941, when the earnings of the company had been less than its capital expenditures, and confined his claim for dividends to the six years from 1942-1947, inclusive.

In urging this new theory petitioner relied heavily upon his counsel's interpretation of this Court's holding in *Wabash Railway Co.* v. *Barclay,* 280 U. S. 197, the *Collins* case in the Ninth Circuit, and the so-called New Jersey dividend rule which has been applied to New Jersey corporations (Petitioner's brief below pp. 34-51). This special doctrine, which had its origin in a New Jersey corporate statutory provision, was initially forecast in *Bassett* v. *United States Cast Iron Pipe & Foundry Co.,* 74 N. J. Eq. 668, 70 A. 929 (1908), affd. 75 N. J. Eq. 539, 73 A. 514 (1909), and was first announced in *Day* v. *United States Cast Iron Pipe & Foundry Co.,* 95 N. J. Eq. 389, 123 A. 546 (1924), affirmed by an equally divided court in 96 N. J. Eq. 736, 126 A. 302.[3]

Petitioner further urged that the alleged surviving dividend rights should be judicially protected either by the court's enjoining the payment of any common dividend (Petitioner's brief below pp. 51-5), or by decreeing that the company not only had power to pay the back dividends but also was under a duty to do so under the facts of the case (Petitioner's brief below pp. 55-62). In this connection petitioner again relied on the *Collins* and the New Jersey decisions to support his position.

As a last resort, petitioner claimed that in the event the Court of Appeals should hold that the payment of dividends was discretionary with the directors and not a matter of right where earnings were not expended for capital improvements, there had been an abuse of discretion within

[3]The New Jersey rule "is a departure from the general rule that the holders of non-cumulative preferred stock lose with the close of the fiscal year all right in the undistributed net profits of that year". *Lich* v. *United States Rubber Co.,* 39 F. Supp. 675, 680 (D. C. N. J. 1941), affirmed on opinion below in 123 F. 2d 145 (C. C. A. 3).

the stricter standard of discretion applicable to preferred dividends (Petitioner's brief below pp. 62-71).

In advancing these separate contentions petitioner did not assert, or even suggest, that the law of New York was controlling, as is now claimed for the first time.

The Court of Appeals unanimously held (1) that under the contract of the Illinois Central Railroad, *i.e.*, the preferred stockholders' resolution, where the directors in the exercise of their discretion determine not to pay dividends in any particular year, no right to those dividends survives in later years, and (2) that there was no abuse of discretion by the directors in not declaring dividends on the preferred stock in the years 1937-47 inclusive, even assuming *arguendo* the petitioner's theory that "the standard of discretion in weighing the propriety of the non-declaration of dividends on such preferred stock is far stricter than in the case of non-declaration of dividends on common stock" (R. 2).[4]

ARGUMENT

I

THE BASIC QUESTION UPON WHICH PETITIONER SEEKS REVIEW BY THIS COURT, *i.e.* WHETHER DIRECTORS HAVE POWER IN SUBSEQUENT YEARS TO DECLARE DIVIDENDS FOR PRIOR YEARS ON NON-CUMULATIVE PREFERRED STOCK, IS COMPLETELY ACADEMIC TO THE DECISION IN THIS CASE.

Petitioner asserts that there is a conflict in the decisions of the Courts of Appeals as to whether earnings not ex-

[4]On this application petitioner no longer attacks the exercise of discretion by directors in not declaring dividends in the years in question and accepts the Court of Appeals decision that there was no abuse of discretion in this regard.

pended for capital improvements in any particular year may be used in subsequent years for the declaration of passed dividends on non-cumulative preferred stock, and further, that the decision of the Court below that such earnings are not available for passed dividends is a violation of the law of the State of New York which must be applied under the rule of *Erie R. R.* v. *Tompkins*. Both of these points are urged by petitioner in support of the single proposition that "the railroad had and still has the *power* to pay the dividends so withheld" (Pet., pp. 2 and 6; italics in original).

This question of "power" to pay passed dividends on non-cumulative preferred stock is completely academic to the decision of the Court below in the case of the Illinois Central.

The right of the non-cumulative preferred stockholders to dividends in any year in the case of the Illinois Central is governed by a contract which provides (App. 29; Find. 5, Def. App. 3):

> "* * * no dividends shall be paid, declared or set apart for payment on the common stock of the Company *in any fiscal year* unless the full dividend on the preferred stock *for such year* shall have been paid or provided for." [5]

Thus it is clear in the case of the Illinois Central that the preference of the non-cumulative preferred stock is limited to *a specific fiscal year*. In view of this, the Court of Appeals rightly concluded (R. 7-8):

> "Here we are interpreting a contract into which uncoerced men entered. Nothing in the wording of that contract would suggest to an ordinary way-

[5] All italics in this brief are supplied unless otherwise noted.

faring person the existence of a contingent or inchoate right to arrears of dividends.

* * *

'a contract is a contract is a contract'

* * *

In sum, we hold that, since the directors did not 'abuse' their discretion in withholding dividends on the non-cumulative preferred for any past years, (a) *no right survived to have those dividends declared,* and (b) the directors had no discretion whatever to declare those dividends subsequently."

The Court of Appeals having decided (a) that under the terms of the contract here involved no right to dividends survives the fiscal year in question, it was quite unnecessary to the decision of this case to determine the further question (b) whether the directors of this corporation under general principles of corporate law, as laid down in the *Wabash* case, would have power to exercise their discretion subsequently and declare dividends for previous years. Since the petition (p. 6) seeks review only of the latter question of law, it is obvious that the basic question presented to this court is purely academic.

II

THE QUESTION OF THE "POWER" OF DIRECTORS TO DECLARE PASSED NON-CUMULATIVE PREFERRED DIVIDENDS IN SUBSEQUENT YEARS PRESENTS NO REAL CONFLICT OF DECISIONS BETWEEN THE CIRCUITS.

Admittedly, no federal question is involved in this case.

In asserting as a basis for certiorari that there is a conflict between Courts of Appeals, petitioner relies on his

counsel's interpretation of this Court's decision in the *Wabash* case and the decision of the Circuit Court of Appeals for the Ninth Circuit in the *Collins* case, which preceded and was quoted at length to this Court in the briefs of the parties in the *Wabash* case. It is petitioner's contention that this Court held in the *Wabash* case that where there are earnings in a particular year and preferred dividends are not declared, the right to such dividends is never lost or destroyed, except where the earnings have been justifiably applied or expended for capital improvements. In other words, it is petitioner's position that if the directors in the exercise of sound discretion use earnings for any other corporate purpose than capital improvements, the dividend rights survive and must be satisfied at some future time before any dividends can ever again be paid on the common stock. A careful analysis of the *Wabash* case demonstrates that petitioner's interpretation of that decision is without merit.

In the first place, that decision was not rendered on any assumption that all the funds which might have been used for preferred dividends had actually been expended in capital improvements. There was an express reference in the complaint and also in the answer to the reservation of funds "as additional working capital and for other proper corporate purposes".

In the second place, there is nothing in the opinion of this Court in the *Wabash* case which recognizes the existence or creation of the rights in non-cumulative preferred stockholders here claimed by petitioner.

The District Court in that case in deciding that the declaration of dividends was a discretionary matter and that no right to non-cumulative preferred dividends sur-

vived the year in question (23 F. 2d at 694-5) refused to follow the decision in the *Collins* case and the so-called New Jersey *Cast Iron Pipe* cases discussed at page 5 above.

In the *Wabash* case, a majority of the Circuit Court of Appeals in reversing the decree of the District Court cited the *Collins* and the New Jersey cases with approval and held that the failure of the directors to declare dividends resulted "only in granting a dividend credit which, at some postponed date, may be paid to preferred A stockholders as dividends under the terms of the contract" (30 F. 2d at 265-7). Judge Learned Hand dissented, pointing out that "there is no rational distinction between working capital and track and equipment" (30 F. 2d at 267).

This Court on certiorari unanimously reversed in an opinion by the late Justice Holmes. Respondent stockholders there, as does the present petitioner, strenuously urged the *Collins* decision upon this Court to support their position that dividend rights survive and are not lost when dividends are not declared out of earnings in prior years.[6] But counsel for the Wabash were successful in persuading this Court not to follow and adopt the rule of the *Collins* case, as the majority of the Court below had done.

In discussing the rights of the non-cumulative preferred stockholders under their contract with the Wabash Railway Company,[7] this Court stated at pages 203-4:

> "By the plain meaning of the words *the holders 'are not entitled, of right, to dividends,* payable out

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[6]Respondents' brief in this Court, pp. 48-51.

[7]The dividend provisions in that suit were almost identical with those involved in the present case (App. 28-30; 280 U. S. at 202).

> of the net profits accruing in any particular year, unless the directors of the Company formally declare, or ought to declare, a dividend payable out of such profits'; in the first instance at least a matter for the directors to determine.
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> * * * * *
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> *When, as was the case here, the dividends in each fiscal year were declared to be non-cumulative and no net income could be so applied within the fiscal year referred to in the certificate, the right for that year was gone.* If the right is extended further upon some conception of policy, it is enlarged beyond the meaning of the contract and the common and reasonable understanding of men."

Since the preferred stockholders in the *Wabash* case urged on this Court the prior holding of the Ninth Circuit in the *Collins* case, which is now relied upon by petitioner in the case at bar, it is clear from the foregoing language of this Court that whatever conflict might have arisen between that decision of the Ninth Circuit and the recent decision of the Court of Appeals for the Second Circuit in the case at bar was completely resolved by this Court's decision in the *Wabash* case; and thus we say that the conflict which petitioner sees between the circuits is a mere fantasy.

What petitioner has done here is to magnify and torture a mere passing remark of Justice Holmes, that earnings of the Wabash had been "justifiably applied by the directors to capital improvements", into a primary holding of the Court, when in fact the "plain meaning" of the Court's decision is directly to the contrary. As the Court of Appeals correctly

said in the instant case petitioner's interpretation of the *Wabash* decision is "untenable" and "irrational."[8]

In addition to the reasons for that conclusion so well stated by the Court below in its opinion (R. 4-6), we respectfully ask: what rational distinction can there be between the situation where earnings are justifiably spent in improving a property (in which case petitioner acknowledges the right to dividends is destroyed), and the situation where earnings must be expended or retained in the sound judgment of directors to meet mortgage debt previously incurred for capital improvements? The latter is precisely the situation in the case at bar (Finds. 20-37, 44, 48; Def. App. 462-8, 471, 473).

At page 4 of the petition great emphasis is placed on the fact that the annual preferred dividend requirements of the Illinois Central during the period in question were only $1,118,742 per year, and that in the years 1942-1949 the company had substantial amounts of cash, temporary cash investments and net income. However, the petitioner completely fails to disclose the very vital facts as to the tremendous amount of mortgage debt (most of it non-callable) which was outstanding in those years and maturing on or before December 31, 1955 (Exh. R-5). We set forth on the following page the table presented at page 4 of the petition, with an additional column showing the amount of mortgage debt outstanding at end of those years and maturing on or before December 31, 1955.

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[8]The Court of Appeals for the Third Circuit has also expressly recognized that this Court did not limit its holding in the *Wabash* case with respect to the loss of dividend rights to situations where the earnings have been expended for capital improvements, *Lich* v. *United States Rubber Co.*, 39 F. Supp. 675 at 682, aff'd on opinion below in 123 F. 2d 145 (1941).

PETITIONER'S TABLE (Petition p. 4)

Year	Net Income	Earned Surplus at Start of Year	Cash at End of Year	Temporary Cash Investment at End of Year	Mortgage Debt (Maturing between January 1, 1950 and December 31, 1955) at December 31
1942.....	$24,914,000	$ 52,949,000	$11,140,000	$27,026,000	$172,944,500
1943.....	25,129,000	56,684,000	24,572,000	39,997,000	156,490,500
1944.....	17,385,000	89,354,000	17,303,000	65,626,000	143,760,500
1945.....	11,406,000	103,654,000	19,015,000	58,287,000	124,348,500
1946.....	7,462,000	107,234,000	13,121,000	53,466,000	115,344,500
1947.....	15,039,000	112,509,000	16,838,000	54,663,000	105,156,000
1948.....	20,949,000	125,475,000	19,850,000	60,093,000[*]	86,300,000
1949.....	16,071,000	144,402,000	20,753,000	55,404,000[*]	56,693,000 (Exh. R-5)

*Full preferred dividends were paid in 1948 and 1949.

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All of the mortgage debt of the Illinois Central maturing between 1950 and 1955 was incurred many years prior to the issuance of the preferred stock here involved. When the preferred stock came along in 1922, the capital improvements for which those millions were borrowed and expended had been furnishing earning power and continued to furnish earning power for the Illinois Central for many years. We therefore ask again: what rational distinction can there be between a situation where moneys are currently expended for capital improvements (thus forever cutting off the right to preferred dividends as petitioner concedes) and the situation where moneys have been spent in the past for capital improvements and current earnings must be expended or set aside to meet the mortgage debt incurred for those earlier capital improvements?

Furthermore, the preferred stockholders in this case (unlike even the *Wabash* case) had the right to change over from their limited income status as 6% preferred stockholders and to reap any benefits accruing from these capital improvements, for this stock is convertible to common stock share for share (App. 29). In the period of 1922-1929, a total of 154,991 of the 341,444 shares of preferred stock was in fact converted by holders in order to obtain the 7% dividends which were then being paid on the common stock (App. 199, Find. 4, Def. App. 2-3), and which were the result of the road or capital improvements supplied by the heavy debt, which unfortunately had to be met in the early 1950's.

Whatever equitable considerations might be advanced in the *Collins* and other cases, for recognizing in noncumulative preferred stock a "right" to dividends in subsequent years, can have no application here, where the earn-

ings have been husbanded or spent to meet debt incurred to create capital improvements in which the preferred stock itself shared, and where there is a conversion privilege through which preferred stockholders have in fact benefited unlimitedly in the past, and can do so in the future.

Even if the decision in the *Collins* case is still considered to be in force and effect, no conflict is presented on any question of federal law, and in determining the question of general contract law involved in this case, clearly neither the Illinois courts nor the New York courts nor the Court of Appeals for the Second Circuit would be bound by the *Collins* decision as a controlling authority.

III

THE COURT BELOW IN HOLDING THAT THE DIRECTORS DID NOT HAVE "POWER" TO DECLARE PASSED DIVIDENDS ON NON-CUMULATIVE PREFERRED STOCK DID NOT VIOLATE *ERIE R. R.* v. *TOMPKINS*.

Since the respondent was incorporated in Illinois, it was agreed by the parties at the outset of the trial that the Illinois law was applicable under *Erie R. R.* v. *Tompkins*. This agreement of the parties, on which the case proceeded in the District Court and the Court of Appeals, was formally noted by the District Court in its opinion as follows (App. 441):

> "It is agreed that the law applicable in the determination of the dividend rights is the law of Illinois, since jurisdiction in this case is based on diversity of citizenship, *Erie Railroad Company* v. *Tompkins*, 304 U. S. 64."

Petitioner's trial counsel expressly stated that the proof he would offer at the trial was not in support of the so-called New Jersey rule (Opening, typewritten transcript pp. 16-17). Likewise, petitioner's counsel did not even suggest that the law of New York was controlling in any way.

An examination of the District Court's opinion will disclose that it properly applied the Illinois law in holding that the declaration of preferred dividends under the stockholders' contract with the company rested solely within the directors' discretion, and that no right to dividends accrued in any year where there were earnings, unless the directors abused their discretion in not declaring dividends for that year (App. 441-5).[9] The learned trial judge also found that both the federal law, embodied in the *Wabash* decision, *as well as the New York law,*[10] were against petitioner's contentions (App. 442, 445-9).

The same authorities which persuaded the District Court to render a decision favorable to the respondent were cited to and followed by the Court of Appeals in affirming the judgment dismissing the complaint. Again, no suggestion was made at any time by the petitioner's counsel that the New York law applied to this situation.

We have not found a single Illinois case which indicates approval of the rule announced in the pre-*Wabash* decision of the Ninth Circuit in the *Collins* case, or which adopts

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[9]*Hofeller* v. *General Candy Corp.*, 275 Ill. App. 89, 96-7 (1934); *Owatonna Metal Products Company* v. *H. D. Hudson Mfg. Co.*, 283 Ill. App. 199, 206-9 (1935); *Gehrt* v. *Collins Plow Co.*, 156 Ill. App. 98, 102-4 (1910); and *Robertson* v. *Bucklen & Co.*, 107 Ill. App. 369, 373 (1903);

[10]*Lockley* v. *Robie*, 276 A. D. 291, 296, affirmed on this point in 301 N. Y. 371 (1950); *Hastings* v. *International Paper Company*, 187 A. D. 404, 414 (1919).

petitioner's narrow limitation of this Court's *Wabash* opinion.

Petitioner now asserts for the very first time, after he has stipulated that the law of Illinois is controlling, and after two other courts have already passed upon his claims, that it is the law of New York which controls, and he further asserts that that law is contrary to the decision announced by the Court of Appeals in the case at bar, in two respects: first, in that the courts of New York interpret the *Wabash* case as the petitioner does, in other words they recognize a right to preferred dividends in past years unless the earnings for those years have been expended for capital improvements; and second, in that the courts of New York recognize a power in the directors to declare dividends on preferred stock in subsequent years.

In support of his first contention petitioner cites *Gallagher* v. *New York Dock Co.*, 19 N. Y. Supp. 2d 789 (Supreme Court, Kings County, 1940), affirmed without opinion 263 A. D. 872, appeal denied 263 A. D. 957 and 288 N. Y. 737.[11] The New York trial court merely quoted a short portion from Judge Holmes' opinion in the *Wabash* case, and there is no indication whatsoever that the court considered that the *Wabash* holding was in any way limited to situations where earnings have been expended for capital improvements.

Petitioner also cites *Diamond* v. *Davis*, 38 N. Y. Supp. 2d 103 (Supreme Court, New York County, 1942), aff'd. 265 A. D. 919, aff'd. 292 N. Y. 554.[12] This case is likewise not in point since it involved a New Jersey corporation, a circumstance which compelled the court to follow and apply

[11]It is noteworthy that this case was not cited nor relied upon by the petitioner in either of the courts below.

[12]Neither of the appellate courts wrote an opinion.

the special New Jersey doctrine which originated in the *Cast Iron Pipe* cases discussed above.

The court made it abundantly clear that in reaching its conclusion it was applying *New Jersey* law. It said (pp. 118, 120):

> "* * * the fixation and limitation of dividends on the preferred stock was within the purview of the law of New Jersey. McVity v. Albro Co., 90 App. Div. 109, 86 N. Y. S. 144, aff'd 180 N. Y. 554, 73 N. E. 1126; McClement v. Supreme Court, Order of Foresters, 222 N. Y. 470, 119 N. E. 99.
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> * * * * *
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> It is therefore necessary to ascertain whether the dividend declared and paid was authorized and legal under the laws of New Jersey.
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> * * * * *
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> There can be no dispute of the fact that the statutory policy of New Jersey permits directors of corporations to define and regulate the respective rights of preferred and common stockholders and to apply such parts of the annual net earnings to the payment of dividends as they may deem proper."

Thus, it cannot be said, as petitioner does, that either the *Gallagher* or the *Diamond* case establishes that the law of New York is in accordance with petitioner's interpretation of the *Wabash* decision.

Petitioner's second contention that the Court of Appeals' decision here conflicts with the New York law has to do with the power of directors to declare and pay "passed dividends". As already stated, the Court of Appeals and the District Court held that, under the contract involved in the case of the Illinois Central, where dividends were not declared by directors in the proper exercise of their discretion, there was no right to have those dividends declared sub-

sequently (App. 475, R. 7). Since the directors of Illinois Central have not declared any back dividends on the preferred stock, and have given no indication that they will ever do so, it was quite unnecessary to the decision at hand for the Court of Appeals to make the additional determination that the directors would have no power to declare such dividends in 1950 or at some subsequent time. Therefore, for an additional reason to that already stated in Point I hereof, this whole question of power is academic.

Were it not, however, the New York law is not at variance with the holding of the Court of Appeals, as petitioner claims. In the *Gallagher* case, despite the statement of petitioner's counsel to the contrary (Petition p. 21), the question of the exercise of such power by the directors of the New York corporation there involved was neither presented for decision nor the subject of decision. In that case a dividend declaration and payment on non-cumulative preferred stock for a certain year was attacked by a common stockholder of the company on the ground that the dividend was paid out of earnings for the year following that for which it was declared. However, it turned out and the Court expressly found that this preferred dividend was paid from the earnings in the year for which it was declared (19 N. Y. Supp. 2d at 794). We repeat that no question was raised nor did the Court decide whether the directors had power to declare a dividend on non-cumulative preferred stock subsequent to the year in which it was earned. In dealing with another contention advanced by plaintiff that there were not sufficient net earnings in certain other years to pay the preferred dividends, which had been declared and paid *during those years,* the New York court did quote from the *Collins* case, but a reading of the opinion will disclose that the principles of that decision were in no way involved,

the court having found from the evidence adduced at the trial that there had been sufficient earnings in each year in question to provide for the dividends declared and paid in those years. The Appellate Division affirmed the lower court's factual findings on the evidence without opinion.[13] Leave to appeal to the Court of Appeals was denied.

Petitioner also relies on *Diamond* v. *Davis* as sustaining his position that the directors have power to declare dividends in respect to prior years. However, as pointed out above on pages 17-18, the New York courts in *Diamond* v. *Davis* were not declaring the law of New York but only the law of New Jersey, which clearly is not involved in the case at bar.

Thus the Court below in holding that the directors did not have power to declare passed dividends on non-cumulative preferred stock did not violate the doctrine of *Erie R. R.* v. *Tompkins*.

We also desire to call this Court's attention to the fact that if this suit had been instituted in the New York state courts, the exercise of discretion by the directors of Illinois Central not to declare and pay dividends in the years in question would not have been disturbed. It is the established policy of the State of New York not to interfere with the internal affairs of a foreign corporation, and as a result of this policy the New York courts refuse to direct the

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[13] "The legal conclusions reached by a court in making a decision, even in an opinion, are not necessarily adopted and approved on appeal where the decision is affirmed without opinion. Only the right of the party to recover is decided and the court is responsible only for that, not for the reasons given nor opinions theretofore expressed. (Citing authorities.) An affirmance may be based on a different theory or on different grounds or on any sufficient ground found in the evidence." *Erie R. Co.* v. *International R. Co.*, 209 A. D. 380, at 384 (4th Dept., 1924), aff'd 239 N. Y. 598; see also *Adrico R. Co.* v. *City of New York*, 250 N. Y. 29, at 44 (1928).

payment of dividends on stock of a company incorporated outside of the state. See *Strassburger* v. *Singer Mfg. Co.*, 263 A. D. 518 (1942); *Goldstein* v. *Lightner*, 292 N. Y. 670 (1944).

CONCLUSION

No question of federal law, and no inconsistency of decision either with this Court, with other circuits, with the law of Illinois, or with the law of New York are presented on this record such as would warrant the granting of a writ of certiorari.

New York, October 2, 1951.

Respectfully submitted,

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